WHY DO DUAL-CLASS FIRMS HAVE STAGGERED BOARDS?

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ABSTRACT

Conventional wisdom regards the combination of a staggered board with a dual-class capital structure as superfluous. However, the incidence of this combination in U.S. firms, identified in this Paper, is not trivial. This Paper considers a few possible motivations for this practice and reports the results of empirical studies conducted on dual-class firms with staggered boards. Significantly, even in the universe of dual-class capital structures, effective staggered boards are associated with lower firm value. These findings suggest that entrenchment may not fully explain the correlation between lower value and staggered boards in single-class firms.

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I. INTRODUCTION

Staggered boards[1] have been at the forefront of the debate about corporate governance for the last decade.[2] The prolific debate about staggered boards has long occupied leading academics, top corporate counsels, institutional investors and corporate boards of large U.S. companies.[3] The persistent focus on staggered boards can be attributed to the prevalence of staggered boards and their role as an important anti-takeover device and a powerful management[4] entrenching mechanism.[5] Recently, this focus culminated in a wave of de-staggering of boards.[6]

Most prior literature that studied staggered boards excluded all firms with dual-class capital structures.[7] The reason for this exclusion was that dual-class capital structures provide an effective and powerful anti-takeover mechanism on their own, so including dual-class firms in studies on the entrenchment effects of staggered boards would have skewed the studies' results.[8] This exclusion, however, may have caused the literature on anti-takeover mechanisms to disregard important interactions between dual-class capital structures and staggered boards. This gap in the literature is especially problematic because a significant number of firms with dual-class capital structures also have staggered boards. Since each structure is widely viewed as an entrenchment mechanism sufficient by itself to prevent hostile takeovers and proxy fights and to enable the incumbents to prevail in any challenge to their reign, the non-trivial incidence of the combination of these two mechanisms is intriguing. The basic puzzle considered by this Paper is: If we already have a dual-class capital structure, why do we need a staggered board?

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[1] Staggered boards are also known as classified boards.

[2] *See* Lucian Arye Bebchuk, et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887 (2002).

[3] *See, e.g.*, Lucian A. Bebchuk, *Wachtell Lipton Was Wrong About the Shareholder Rights Project*, HARV. L. SCH. (Apr. 9, 2013), http://blogs.law.harvard.edu/corpgov/2013/04/09/wachtell-lipton-was-wrong-about-the-shareholder-rights-project/.

[4] For ease of exposition, the use of manager and management will generally refer to officers and directors of a corporation.

[5] *See, e.g.*, Lucian Bebchuk, *Giving Shareholders a Voice*, N.Y. TIMES: DEALBOOK, Apr. 19, 2012, http://dealbook.nytimes.com/2012/04/19/giving-shareholders-a-voice/?_r=0 ("Staggered boards have long been a key mechanism for insulating boards of publicly traded firms from shareholders.").

[6] *See, e.g.*, Bebchuk, *supra* note 3 (reporting "a large-scale movement by S&P 500 and Fortune 500 companies toward annual elections.").

[7] *See, e.g.*, Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409, 418 (2005); *see* Mira Ganor, *Why do Managers Dismantle Staggered Boards?*, 33 DEL. J. CORP. L. 149, 165 (2008).

[8] Bebchuk & Cohen, *supra* note 7, at 14 ("[T]he holding of superior voting rights is likely to be the key for entrenching incumbents.").

Understanding what would seem to be a redundant combination of two of the most potent anti-takeover mechanisms is not only interesting but also may be especially important at present. Pressure to dismantle staggered boards has led to a wave of de-staggering among public companies.[9] At the same time, the use of dual-class capital structures has been non-negligible.[10] In addition, the use of staggered boards in initial public offerings (IPOs) has actually increased.[11]

This Paper evaluates several possible explanations for the combined use of dual-class capital structures and staggered boards. For example, although a dual-class capital structure can substitute for a staggered board as a superior anti-takeover mechanism, the interaction between the two mechanisms can have the socially positive effect of strengthening the independent directors at the expense of the insiders. A dual-class capital structure bestows control on a shareholder whose interests may not be aligned with those of the shareholders as a whole, since the economic interest of shareholders whose stock enjoys superior voting rights is misaligned with (that is, disproportional to) their voting power, a circumstance that may incentivize them to extract large private benefits of

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[9] *Towards Board Declassification in One-Hundred S&P 500 and Fortune 500 Companies: Announcing the SRP's 2012-2013 Results*, SHAREHOLDERS RIGHTS PROJECT (Oct. 29, 2013), http://srp.law.harvard.edu/newsletters/10-29-2013_SRP_newsletter.shtml (predicting "declassification of the boards of over 60% of the S&P 500 companies that had classified boards as of the beginning of 2012" by the end of 2014).

[10] *See CII Urges Exchanges to Address Shareowner Rights*, BUSINESS WIRE (Oct. 2, 2012, 8:58 AM), http://www.businesswire.com/news/home/20121002005978/en/CII-Urges-Exchanges-Address-Shareowner-Rights-Corporate [hereinafter *CII Urges*] ("[A] significant number of start-up companies are opting for the multi-class stock structure. Twenty of 170 initial public offerings (IPOs) between January 2010 and March 2012 were by companies with a multi-class, unequal voting stock structure."); *see also Global Governance Program Update*, CALPERS.CA.GOV (Aug. 13, 2012), http://www.calpers.ca.gov/eip-docs/about/board-cal-agenda/agendas/invest/201208/item07b-00.pdf (raising concern about the "[i]ncreasing prevalence of dual class voting structures" in IPOs); *see also* Letter from Elizabeth Warren, U.S. Senator, to John Carey, Vice President—Legal, NYSE Regulation, Inc. & Edward Knight, Executive Vice Pres., NASDAQ OMX (June 5, 2013), http://www.warren.senate.gov/files/documents/Senator%20Warren%20letter%20to%20NYSE,%20Nasdaq%20-%206-5-2013.pdf [hereinafter Letter from Senator Warren] ("The number of public companies using multi-class stock has risen sharply in recent years.").

[11] *See, e.g.*, Steven M. Davidoff, *The Case Against Staggered Boards*, N.Y. TIMES: DEALBOOK, Mar. 20, 2012, http://dealbook.nytimes.com/2012/03/20/the-case-against-staggered-boards/ ("[C]ompanies undertaking initial public offerings . . . .. are increasingly choosing to go public with staggered boards.").

control. The staggered board can serve to protect the outside directors from the wrath of the controlling shareholder who owns the superior class of stock, and thereby enable the directors to discharge their fiduciary duties in a way that promotes the interests of the shareholders as a whole. Thus, to the extent that independent directors are neither seeking the favor of the controlling shareholder nor influenced by the collegial pressure of the inside directors,[12] the combined use of the staggered board and the dual-class capital structure may be shareholder-value-increasing.

Conversely, even though the controlling shareholder's interests may not always be aligned with the interests of the other shareholders, the controlling shareholder is nonetheless still a shareholder. Thus, her interests may be more aligned with those of the other shareholders than with the interests of a management entrenched by a staggered board and lacking any significant equity interest in the company. The staggered board may allow management to shirk and extract private benefits of control even in the dual-class firm. Hence, the presence of a staggered board in a firm with a dual-class capital structure may be shareholder-value-decreasing.

Alternatively, with the increased pressure to improve corporate governance,[13] managers may prefer to have as much protection as possible. Fearing an overwhelming pressure to relinquish a staggered board or a dual class may motivate the decision not to choose between the two mechanisms but rather to install both. With the frequent calls for one-share-one-vote and

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[12] *See, e.g.*, Melvin Eisenberg, *Self-Interested Transactions in Corporate Law*, 13 J. CORP. L. 997, 1002 (1988) (questioning the independence of disinterested directors).

[13] *See, e.g.*, Ben Protess & Katherine Reynolds Lewis, *Once-Reticent Investors Join Shareholder Revolts*, N.Y. TIMES: DEALBOOK, June 7, 2012, http://dealbook.nytimes.com/2012/06/07/once-reticent-investors-join-shareholder-revolts/ ("Emboldened by new regulations — and angered by laggard stock performance and recent scandals — this new crop of activists is voting down company policies and backing proposals to reform corporate boards."); *see also* David Gelles, *Boardrooms Rethink Tactics to Defang Activist Investors*, N.Y. TIMES: DEALBOOK, Nov. 11, 2013, http://dealbook.nytimes.com/2013/11/11/boardrooms-rethink-tactics-to-defang-activist-investors/ ("Now, with dozens of activist hedge funds pushing for change at companies large and small, executives, directors and advisers are scrambling to calibrate their defenses to this new and in many ways more challenging threat . . . . With paranoia at record highs, some companies are going further."); *see also* Lucian A. Bebchuk, *The Myth That Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1687 (2013) (showing that "existing (or higher) levels of board insulation produce long-term costs that exceed their long-term benefits. Providing shareholders with power and rights that enable them to hold directors accountable is overall beneficial for companies and their long-term shareholders in both the short term and the long term.").

pressure to de-stagger boards, these potent mechanisms, when used separately, may no longer provide sufficient assurance for the incumbents.

The Paper discusses additional explanations of the combined use of a staggered board and a dual-class capital structure. Some explanations hypothesize that such use promotes shareholder welfare, whereas others hypothesize that it protects the controlling incumbents to the shareholders' detriment. To understand this phenomenon better, I conducted empirical studies and tested the opposite forces at play. In addition, since a staggered board offers undisputable benefits, such as continuity of management, and since the entrenchment attribute may already be covered by the dual-class capital structure, the study of the combined use of these mechanisms may reveal the market sentiments towards these benefits of the staggered board.

Indeed, the empirical study of the dual-class firms found a statistically significant and economically meaningful correlation between staggered boards and firm performance, measured by Tobin's Q.[14] The correlation was negative.[15] This negative correlation is surprisingly similar to the negative correlation between staggered boards and Tobin's Q reported by leading studies of staggered boards in single-class firms.[16] Given that entrenchment is the prevailing explanation for the reduced firm performance associated with staggered boards, the presence of a similar reduction in firm performance in firms with dual-class capital structures is particularly puzzling because the dual-class capital structure itself is a strong source of entrenchment. Thus, the empirical findings of this Paper call into question the strength of the entrenchment explanation.

This Paper proceeds as follows. Part I describes the mechanics of dual-class capital structures and staggered boards, and considers their advantages/disadvantages when used independently of each other. Part II describes the combined use of these mechanisms, its incidence, and why it is puzzling in light of current scholarship, such as the seminal work of Lucian Bebchuk and Alma Cohen.[17] Part III presents hypotheses that explain possible motivations for this combined use. Part IV describes the empirical studies I conducted and their results. A conclusion follows.

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[14] Tobin's Q is the ratio of the market value of assets to replacement cost of assets. *See, e.g.*, Paul Gompers et al., *Corporate Governance and Equity Prices*, Q.J. ECON. 118, 126~~107–55~~ (2003) ("Our valuation measure is Tobin's Q, which has been used for this purpose in corporate governance studies since the work of Demsetz and Lehn [1985] and Morck, Shleifer, and Vishny [1988]. We follow Kaplan and Zingales' [1997] method for the computation of Q")..

[15] *See, e.g., infra* Table II.

[16] *See e.g.*, Bebchuk & Cohen, *supra* note 7, at 18-19.

[17] Bebchuk & Cohen, *supra* note 7.

II. OVERVIEW OF THE TWO FUNDAMENTAL ANTI-TAKEOVER MECHANISMS

A. The Dual-Class Capital Structure

1. Mechanics

A company with a dual-class capital structure has two classes of shares. Each class may be assigned different rights.[18] Usually, one class has significantly more votes per share than the other class.[19] A ratio of 1:10—where one class has ten votes per share and the other class has only one vote per share—is common.[20] At the same time, the cash-flow rights of both classes are usually identical.[21] Thus, the dual-class capital structure allows for the separation of ownership and control:[22] The owners of the superior voting class may control the shareholder vote but own fewer cash-flow rights than the owners of the other class of shares.

2. Benefits

The dual-class capital structure may serve social welfare as a whole in certain situations where increasing shareholder welfare may conflict with increasing the welfare of other stakeholders, such as the general public. An example of this misalignment of interests can be found in the media industry, where the twin goals of preserving editorial independence and

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[18] *See, e.g.*, DEL. CODE ANN. tit. 8, § 151 (2013) (which allows a corporation to issue shares with different voting power).

[19] *See, e.g.*, Harry DeAngelo & Linda DeAngelo, Managerial Ownership of Voting Rights: A Study of Public Corporations with Dual Classes of Common Stock, 14 J. FIN. ECON. 33, 34 (1985) (studied dual class firms and found that "corporate officers and their families hold a median 56.9% of the votes and 24.0% of the common stock cash flows.").

[20] *See, e.g.*, American Greetings Corp., Annual Report (Form 10-K) 15 (Feb. 29, 2012), http://www.sec.gov/Archives/edgar/data/5133/000119312512194474/d241869d10k.htm ("Our authorized capital stock consists of Class A common shares and Class B common shares. The economic rights of each class of common shares are identical, but the voting rights differ. Class A common shares are entitled to one vote per share and Class B common shares are entitled to ten votes per share.").

[21] *Id.*

[22] *See generally,* CONCENTRATED CORPORATE OWNERSHIP, (R. Morck, ed. 2000), 445-60 ("dual class equity structures—produce a separation of control from cash-flow rights."), http://www.law.harvard.edu/faculty/bebchuk/pdfs/2000.Bebchuk-Kraakman-Triantis.Stock.Pyramids.pdf.

maximizing profits may not always coincide.[23] The New York Times Company, for instance, has a dual-class capital structure with one class of shares entitled to superior rights, including the right to vote for 7 out of 11 of the company's directors.[24] The vast majority of the shares of the superior class are held by a trust whose declared objective is "to maintain the editorial independence and the integrity of The New York Times and to continue it as an independent newspaper, entirely fearless, free of ulterior influence and unselfishly devoted to the public welfare."[25]

Another example for the potential benefit of the dual-class capital structure can be found in the startup industry. Without the ability to control the public company, some entrepreneurs may prefer to keep the company private or at least (inefficiently) delay going public in order to maintain control.[26] A dual-class capital structure may persuade controlling shareholders of closely held corporations to raise capital from the public, because the dual class structure allows the company to exchange cash-flow rights for capital that may be needed for efficient expansion, without relinquishing control.[27] Thus, the dual-class capital structure may help small companies grow and enhance the economy.

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[23] *See, e.g.*, Felix Salmon, *The Financial Times Will Be in Good Hands,* N.Y. TIMES, July 23, 2015, http://www.nytimes.com/2015/07/23/opinion/the-financial-times-will-be-in-good-hands.html?_r=0.

[24] *See The New York Times Company: Notice of 2012 Annual Meeting and Proxy Statement*, THE N.Y. TIMES CO., INVITATION TO 2012 ANNUAL MEETING OF STOCKHOLDERS 7 (Mar. 9, 2012), http://investors.nytco.com/files/doc_financials/proxy/2012_Proxy_Statement.pdf ("The Certificate of Incorporation of the Company provides that Class A stockholders have the right to elect 30% of the Board of Directors (or the nearest larger whole number). Accordingly, Class A stockholders will elect four of the 11 directors; Class B stockholders will elect seven directors.")

[25] *Id.*

[26] *See, e.g.*, Alexia Tsotsis, *Microsoft: "Yeah, We Tried to Acquire Facebook."*, TECHCRUNCH (Dec. 9, 2010), *http://techcrunch.com/2010/12/09/fritz-lanman-microsoft-tried-to-acquire-facebook/* (quoting Mr. Zuckerberg telling Microsoft's CEO: "I don't want to sell the company unless I can keep control.") (maintaining control of the company may play a major role in the decision not to sell the company).

[27] Even though Facebook raised capital from the public, its controlling shareholder, Mark Zuckerberg, maintained his control. *See, e.g.,* Dan Bigman, *Facebook Ownership Structure Should Scare Investors More Than Botched IPO,* Forbes (May 23, 2012), http://www.forbes.com/sites/danbigman/2012/05/23/facebook-ownership-structure-should-scare-investors-more-than-botched-ipo/ ("he owns about 18% of the company, but controls more than 50% of the voting power").

3. Disadvantages

Since the dual-class capital structure misaligns ownership and control, it may have socially undesirable effects. The controlling shareholder of a dual-class firm may lack the right incentives to maximize the total welfare of the firm and may prefer to pursue private benefits. News Corp. is another example of a firm with a dual-class capital structure.[28] The dual-class capital structure enabled News Corp.'s controlling shareholder and chief executive officer, Rupert Murdoch, to retain his son, James Murdoch, on the company's board of directors despite opposition from other shareholders.[29]

Generally, studies have found that dual-class capital structures are associated with long-term underperformance of controlled firms,[30] underinvestment, and lower sales growth and valuations.[31] Nonetheless, in recent years, the use of dual-class capital structures has increased.[32]

B. The Staggered Board

1. Mechanics

The directors of a staggered board are divided into classes. At each annual meeting, the shareholders vote for just one class of directors.[33] Usually, the board is divided into three classes of directors and each class is elected for a three-year term.[34] Thus, winning the shareholder vote in at

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[28] *See* NEWS CORP., 2015 Annual Report (Form 10-K) 30 (Aug. 13, 2015), http://investors.newscorp.com/secfiling.cfm?filingID=1193125-15-288946&CIK=1564708 ("the Company's Restated Certificate of Incorporation and Amended and Restated By-laws provide for, among other things: a dual class common equity capital structure.").

[29] *See, e.g.*, Jeff Green & Arian Levy, *Zuckerberg Grip Becomes New Normal in Silicon Valley*, BLOOMBERG (May 6, 2012, 11:01 PM), http://www.bloomberg.com/news/2012-05-07/zuckerberg-stock-grip-becomes-new-normal-in-silicon-valley-tech.html ("James Murdoch, the deputy chief operating officer, would have lost his seat on the board last October at the company's annual meeting without his father's votes.").

[30] *See, e.g.*, IRRC Press Release, *New Study Says Multiclass Voting Companies Underperform, Riskier*, IRRC INSTITUTE (Oct. 2, 2012), http://irrcinstitute.org/news/multiclass-voting-companies-underperform-riskier_pr_10-02-2012.php ("[C]ontrolled companies - particularly those with multiple classes of shares - generally underperform over the long term.").

[31] *See, e.g.*, Paul Gompers, et al., *Incentives vs. Control: an Analysis of U.S. Dual-Class Companies* (Nat. Bureau of Econ. Res., Working Paper No. 10240, 2004), http://www.nber.org/papers/w10240.pdf.

[32] *See generally supra* note 10.

[33] *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(d) (2013).

[34] *See, e.g.*, Bebchuk et al., *supra* note 2, at 893.

least two annual meetings of the shareholders is required in order to replace the majority of the board members.[35] An "effective staggered board" is a staggered board that cannot be easily dismantled or circumvented by the shareholders.[36] For example, if a charter provision establishes the staggered board, the shareholders cannot de-stagger the board without the approval of the board itself.[37]

2. Benefits

Proponents of staggered boards commonly cite board continuity and stability as benefits recommending their use. In addition, it is argued that staggered boards help "attract and retain committed directors."[38] Because directors who serve on staggered boards are elected for a relatively long term—usually three years—it is further argued that they can "develop a deeper knowledge" of the firm and its operating environment and "focus on long-term strategies."[39] Similarly, it is argued that staggered boards help outside directors to be independent of the company's officers and thus reduce agency costs and improve the corporate governance of the company.[40] While these are indeed desirable benefits, Bebchuk, Coates, and Subramanian pointed out in their important paper on staggered boards that these benefits can be easily achieved through other instruments such as policies and bylaws.[41] Proponents of staggered boards argue that, when a firm faces a potential hostile takeover, the staggered board can enable management to negotiate a better deal for the shareholders and prevent them from being fooled by a low-ball offer. The failed attempts of hostile takeovers of the fertilizer manufacturer and distributer CF Industries Holdings, Inc., and of the industrial gases supplier Airgas Inc., are anecdotal evidence of this assertion.[42] The staggered boards, then in place at

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[35] *Id.* at 890.

[36] *Id.* at 894 ("If [a staggered board] is installed in the charter, directors may only be removed for cause, and shareholders may not 'pack the board' by increasing the number of directors and filling the vacancies created, then we characterize the [staggered board] as an 'effective staggered board' (ESB)—one that cannot be dismantled by a hostile bidder without first winning control of the board.").

[37] *See id.* at 894 (noting that in all states, repealing a charter based staggered board requires the approval of both the board and the shareholders); *see, e.g.*, DEL. CODE ANN. tit. 8, § 242(b)(1)-(2) (2013).

[38] Red Hat, Inc., Proxy Statement (Schedule 14A) at 14 (June, 2013), http://www.sec.gov/Archives/edgar/data/1087423/000119312513254913/d540352dpre14a.htm.

[39] *Id.*

[40] *See, e.g.*, Bebchuk et al., *supra* note 2, at 896-900 (summarizing the "justifications for staggered boards.").

[41] *Id.* at 897-98.

[42] *See* GEORGESON, 2012 ANNUAL CORPORATE GOVERNANCE REVIEW 7 (2012), http://www.georgeson.com/us/resource/Pages/acgr.aspx.

both firms, helped them fend off hostile takeovers by bidders whose bids the firms' stock prices later surpassed by a substantial margin.[43]

3. *Disadvantages*

The combination of a shareholder-rights plan, commonly known as a poison pill,[44] with an effective staggered board creates an impenetrable antitakeover mechanism.[45] The poison pill is a mechanism that prevents a hostile bidder from acquiring a sizeable stake in the company by vastly diluting the acquirer's equity holdings upon triggering a threshold level of stock ownership, thus rendering the acquisition economically prohibitive.[46] As a result, before the hostile bidder can take over the firm, the board has to redeem the poison pill, effectively requiring the bidder to gain control of the board first.[47] When the board is staggered, however, gaining control of the board requires successful proxy-fights in at least two annual shareholder meetings.[48] Since a poison pill can be implemented at any time without the shareholders' approval, a staggered board serves as a powerful entrenchment mechanism, which secures the manager's job.[49]

Empirical studies found support to the entrenchment attribute of the staggered board: a staggered board almost doubles the probability that a target company will remain independent.[50] In addition, studies found that staggered boards are associated with both lower market values[51] and reduced shareholder returns in successful hostile takeovers.[52] Importantly, studies found support for the view that staggered boards are not merely associated with lower shareholder value but that staggered boards are, in fact, causing reduced shareholder value.[53] Accordingly, institutional

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[43] *Id.*; Liz Hoffman, *Investors Press Airgas To Destagger Board*, LAW360.COM (Aug. 7, 2013, 3:53 PM), http://www.law360.com/articles/463213/investors-press-airgas-to-destagger-board ("Since the chase ended, Airgas' stock is up nearly 65 percent.").

[44] *See* Bebchuk et al., *supra* note 2, at 904-05 (for a discussion on poison pills).

[45] *Id.* at 903-04.

[46] *Id.* at 904.

[47] *Id.* at 905.

[48] *Id.* at 899.

[49] *See, e.g.*, Bebchuk & Cohen, *supra* note 7, at 412.

[50] *See* Bebchuk et al., *supra* note 2, at 891.

[51] *See, e.g.*, Bebchuk & Cohen, *supra* note 7, at 412.

[52] *See* Bebchuk et al., *supra* note 2, at 891.

[53] *See, e.g.*, Olubunmi Faleye, *Classified Boards, Firm Value, and Managerial Entrenchment*, 83 J. FIN. ECON. 501, 501 (2006). After "several econometric attempts" and "sampling procedures aimed at reducing the likelihood" that the choice of the structure of the board was driven by performance, Faleye concluded that "the results presented in this section do not support a self-selection argument. Rather, they are consistent with classified boards hindering the effectiveness of corporate governance and hurting the firm's ability to create value for its

investors generally oppose staggered boards in favor of annual elections of all board members.[54]

III. THE PUZZLE: THE COMBINATION OF A DUAL-CLASS CAPITAL STRUCTURE WITH A STAGGERED BOARD

Both the dual-class capital structure and the staggered board, described in the previous Part, are exceptionally powerful anti-takeover mechanisms.[55] Each mechanism on its own provides the incumbents with ample protection and entrenchment.[56] And yet, the study reported in this Paper (the "Study") found that a significant number of firms with a dual-class capital structure also have a staggered board.

To check the incidence of the combination of a dual-class capital structure with a staggered board, the Study used The Corporate Library dataset, which covers the 3,000 U.S. firms included in the S&P Index, the Fortune Index, and the Russell Index.[57] These firms are the largest U.S. firms and together represent about 98% of the market.[58] In 2011, the most recent year available in the dataset, the Study identified 299 firms with a dual-class capital structure.[59] Of these firms, ninety-two (or about 30%) had also a staggered board.[60] About a third of these staggered boards (twenty-

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shareholders." *Id.* at 504, 511; Bebchuk & Cohen, *supra* note 7, at 412 ("[P]rovide some suggestive evidence that staggered boards at least partly bring about, and not merely reflect, a lower firm value."); Alma Cohen & Charles C.Y. Wang, *How Do Staggered Boards Affect Shareholder Value? Evidence from a Natural Experiment*, 110 J. FIN. ECON. 627, 628 (2013) ("We find evidence consistent with market participants viewing the antitakeover force of staggered boards as bringing about, and not merely reflecting, reduced shareholder value.").

[54] *See, e.g.*, GEORGESON, *supra* note 42, at 7 ("[T]he voting policies adopted by a large majority of institutions is fairly well decided against [staggered boards].").

[55] *See, e.g.*, Gompers, et al., *supra* note 31, at 9 ("[A] dual-class structure is perhaps the most powerful antitakeover protection possible . . . .").

[56] *Id.* at 9 ("[F]irms with a dual-class structure may find most other protections to be superfluous."); Lucian Bebchuk, et al., *What Matters in Corporate Governance*, 22 REV. FIN. STUD. 783, 797 (2009) ("We excluded firms with a dual class structure. In these companies the holding of superior voting rights might be sufficient to provide incumbents with a powerful entrenching mechanism that renders other entrenching provisions relatively unimportant.").

[57] *See, e.g.*, Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 Va. L. Rev. 935, 986.

[58] *See Russell 3000 Index*, FTSERUSSELL.COM (April 12, 2016), ftserussell.com/index-securities/index-spotlights/us-equity-indexes (approximately 98% of the investable U.S. equity market are represented in the Russell 3000 index).

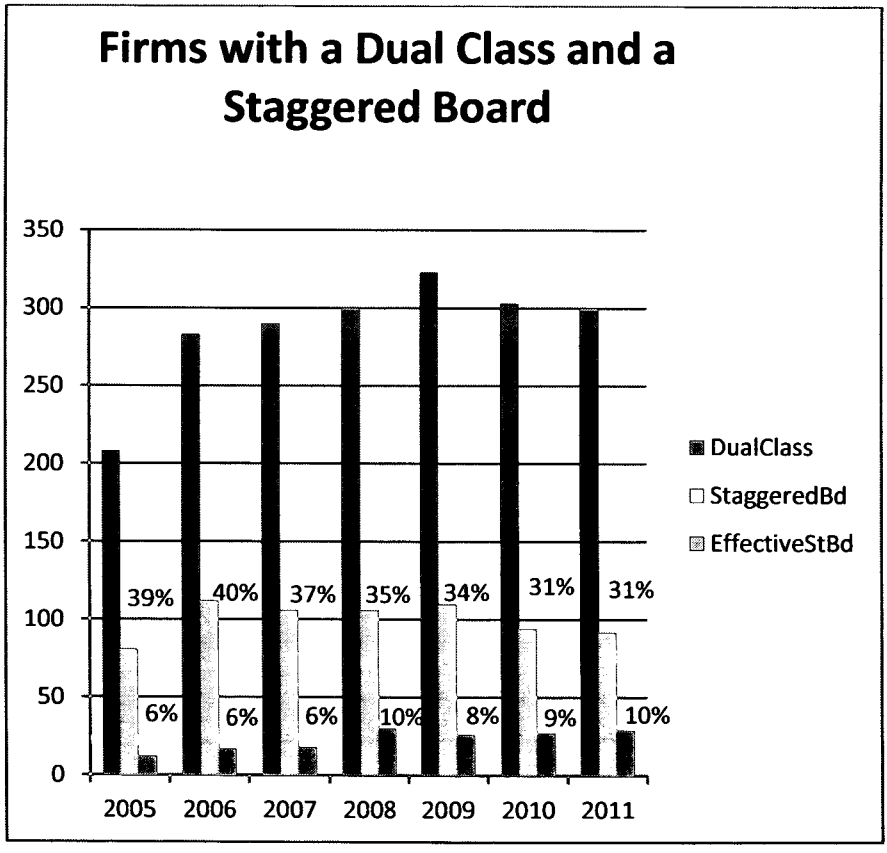
[59] *See* Figure I.

[60] *See* Figure I.

nine boards) were effective staggered[61] boards.[62] Thus, about 10% of the firms with a dual-class capital structure also had an effective staggered board.

Looking at previous years reveals a similar picture. In 2010, the Study found 303 [277 incorporated in the U.S.][63] firms with a dual-class capital structure.[64] Of these, 94 [88] had a staggered board, and 27 [27] of these boards were effective staggered boards.[65] These figures have remained relatively constant over time, as illustrated by Figure I below, which shows the incidence of firms with both a dual-class capital structure and a staggered board for the seven-year period starting in 2005.[66]

Figure I



[61] *See* Bebchuk et al., *supra* note 2 (for the definition and significance of an effective staggered board as opposed to an ineffective staggered board).
[62] *See* Figure I.
[63] *See* Figure I.
[64] *See* Figure I.
[65] *See* Figure I.
[66] It should be noted that in 2005 the total sample in the dataset includes only 2,000 firms.

A recent study by the Investors Responsibility Research Center (IRRC) Institute found that the incidence of staggered boards is about 25% in controlled companies[67] and almost 44% in companies that are not controlled.[68] The IRRC Institute's study focused on the fact that relatively fewer companies have a staggered board when the company is controlled—and attributed it to "classified boards provid[ing] little benefit to insiders at controlled companies."[69] This Paper, however, focuses on the fact that a significant number of controlled companies, about one in four, nonetheless have a staggered board.[70] If it does not provide a benefit, as the IRRC suggested, why then does a significant number of controlled companies choose to have a staggered board?

Similarly, studies of large IPOs of controlled U.S. firms (measured by deal size) also found a high incidence of staggered boards in these firms.[71] The use of a staggered board in controlled firms seems even more prevalent in recent large IPOs of U.S. firms.[72] In the two-year period starting with the third quarter of 2011, 83% of these firms had a staggered board.[73]

This relatively high incidence of the combined use of two of the strongest anti-takeover mechanisms presents an opportunity to learn more about anti-takeover mechanisms and the motivations behind their employment. The utility of combining these two potent mechanisms—a dual class and a staggered board—is not obvious. To the contrary, on its face, this combination would seem superfluous and redundant.[74] In the

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[67] A controlled company is defined as a company in which "a significant amount of the vote is controlled by one party through a sizeable ownership stake or, alternately, through a multiclass capital structure created specifically to allow voting power to be disproportionate to capital commitment." IRRC INSTITUTE, CONTROLLED COMPANIES IN THE STANDARD & POOR'S 500: A TEN YEAR PERFORMANCE AND RISK REVIEW 18 (2012), http://irrcinstitute.org/pdf/FINAL-Controlled-Company-ISS-Report.pdf.

[68] *Id.* at 13.

[69] *Id.*

[70] *Id.*

[71] DAVIS POLK, CORPORATE GOVERNANCE PRACTICES OF U.S. INITIAL PUBLIC OFFERINGS (2011), http://www.davispolk.com/files/uploads/CapitalMarkets/103111_CorpGovPractices_Booklet__Controlled_Included.pdf; DAVIS POLK, CORPORATE GOVERNANCE PRACTICES IN U.S. INITIAL PUBLIC OFFERINGS (2014), http://www.davispolk.com/sites/default/files/ControlledCompanySurvey.pdf.

[72] Davis Polk reported that 64% of top IPOs of U.S. controlled firms had a staggered board in the period starting in 2009 through August 2011 and 83% of similar firms had a staggered board in the following two-year period. POLK (2011), *supra* note 71, at 2; POLK (2014), *supra* note 71, at 4.

[73] POLK (2014), *supra* note 71.

[74] *See, e.g.*, Gompers *et al.*, *supra* note 31, at 9.

following Part, I will discuss a few hypotheses that may explain this surprising phenomenon.

IV. THE HYPOTHESES

This Section now turns to consider the motivation for having a staggered board even though the capital structure is bifurcated, giving the controlling shareholder more votes than her capital interest. Possible explanations range from those positing an increase in total shareholder value, on one end of the spectrum, to those positing a benefit to the controlling shareholder, on the other—the notion that combining a staggered board with a dual-class capital structure could enable the controlling shareholder to solidify her reign and extract further private benefits at the expense of the rest of the shareholders and the company as a whole.[75]

A. A Staggered Board as a Counterbalancing Mechanism

A staggered board is often criticized as an inefficient tool that entrenches the incumbent by preventing hostile takeovers and proxy fights, thus enabling the incumbent to shirk and extract private benefits of control at the expense of the shareholders.[76] As Bebchuk and Cohen showed empirically in their paper, a staggered board is associated with lower firm performance and lower shareholder value.[77] However, Bebchuk and Cohen's paper—including their criticism of the staggered board—focused only on single-class firms.[78]

The dual-class capital structure is a strong anti-takeover mechanism that entrenches the incumbent management, who follows the wishes of the controlling shareholder.[79] The controlling shareholder, who owns the superior class of shares, has the power to decide the future of the company and prevent the replacement of the management.[80] Thus, in the context of the dual-class firm, the anti-takeover attribute of the staggered board may not be relevant, because it is the dual-class capital structure that is responsible for entrenching the management and preventing a hostile takeover.

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[75] *See infra* Part IV.
[76] *See generally* Bebchuk, & Cohen, *supra* note 7.
[77] *Id.*
[78] *Id.* at 418.
[79] *Id.* ("[In] firms with a dual class structure... the holding of superior voting rights is likely to be the key for entrenching incumbents.").
[80] *Id.* at 413.

A company with a dual-class capital structure may enjoy the benefits of the staggered board without regard to its anti-takeover aspect.[81] The potential benefits of the staggered board to shareholder welfare are recognized also in the regular, single-class context. However, in that context, these benefits may be overshadowed by the negative entrenchment effects of the staggered board. This seems to be the case especially with effective staggered boards, in which the board structure constitutes a very strong anti-takeover mechanism.[82]

In fact, the staggered board may have a special *positive* role in the controlled dual-class firm. A dual-class capital structure may entrench the incumbent managers and directors, who are supported by the controlling shareholder (who holds the majority of the votes even without the majority of the equity), and prevent proxy fights and hostile takeovers. Yet, independent, outside directors who do not follow the wishes of the controlling shareholder are not protected by the dual class structure—rather, they may find themselves exposed to the wrath of the controlling shareholder. The existence of a staggered board may empower the independent directors, not just vis-à-vis the insiders, but also the controlling shareholder. The staggered board may allow the directors to exercise their fiduciary duties for the benefit of the shareholders as a whole without facing an imminent threat from the controlling shareholder.[83] Thus, in this special case of combining two entrenchment mechanisms, the two "wrongs" may ultimately make a "right": a dual-class firm may perform better with a staggered board and enhance the shareholder welfare.

On the other hand, however, without a staggered board, the controlling shareholder can override the management: it can, for example, decide against a takeover promoted by the management or replace the management over the objections of the incumbents.[84] Yet, if the board is effectively staggered, even the controlling shareholder cannot force the incumbent to repeal a poison pill, even if the incumbent was personally elected by the controlling shareholder, because a director on a staggered board can be

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[81] *But see supra* Part II.B.2 (discussing the potential benefits of a staggered board).

[82] *Cf.,* Guhan Subramanian, *Board Silly*, N.Y. TIMES, Feb. 14, 2007, http://www.nytimes.com/2007/02/14/opinion/14subramanian.html?_r=0. (arguing that bylaws-based staggered boards should replace effective staggered boards since the former will allow firms to enjoy the benefits of staggered boards without the anti-takeover effect).

[83] *Id.*

[84] This is because the majority of the votes of the shareholders, which the controlling shareholder holds, give the controlling shareholder the power needed for blocking fundamental transactions, such as blocking a merger. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251(c) (2014).

removed only for cause.[85] Thus, there seems to be a tradeoff between vesting control in an agent or in a controlling shareholder who owns a voting right that is disproportionate to her capital stake in the company. To be sure, this analysis does not take into account the influence that the controlling shareholder has even on independent directors.[86] The disinterestedness of independent directors is generally questioned because of their collegial relationships with the inside directors and because of the factual challenge of having "no significant relationship of any kind with ... the subject matter."[87] The clout a controlling shareholder may have with independent directors by the sheer virtue of her status qua controller may give rise to further doubt about these directors' actual independence.[88] On the other hand, the existence of a controlling shareholder may subject the actions of the directors of a controlled firm to additional scrutiny,[89] thus, encouraging directors to take additional care ex ante in the exercise of their fiduciary duties. This theory finds anecdotal support in the notable and recent case of the failed takeover attempt of Airgas, in which the directors who were nominated to the target's board by the hostile bidder "were some of the most vocal opponents to the . . . offer," made by the nominating hostile bidder.[90]

B. Directors' Tenure and Lower Compensation

A staggered board provides the director with the security of a (typically) three-year tenure.[91] This means that the director need not stand for reelection annually, but will serve a three-year term before facing the shareholders' vote.[92] In addition, in jurisdictions such as Delaware—the state in which most U.S. publicly traded companies incorporate—directors

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[85] *See* DEL. CODE ANN. tit. 8, § 141(k)(1) (2014) ("A director on a staggered board can be removed only for cause, unless the certificate of incorporation provides otherwise.").

[86] *See, e.g.*, Melvin Eisenberg, *Self-Interested Transactions in Corporate Law*, 13 J. CORP. L. 997 (1988) (questioning the independence of disinterested directors).

[87] *Id.* at 1002.

[88] *Id.*

[89] *See, e.g., Kahn v. Lynch Comm. Sys.*, 638 A.2d 1110, 1117 (Del. 1994) (holding that the entire fairness standard of review will apply to a merger transaction with a controlling shareholder even though a special committee approved the transaction).

[90] *See, Air Products & Chemicals, Inc. v. Airgas, Inc.*, 16 A.3d 48, 89 (Del. Ch. 2011) ("[T]he Airgas board unanimously—including the Air Products Nominees—rejected the seventy-dollar offer. Interestingly, the Air Products Nominees were some of the most vocal opponents to the seventy-dollar offer.").

[91] Red Hat, Inc., 2013 Proxy Statement (Schedule 14A) 14 (June, 2013).

[92] The usual term of a staggered board is three years. Certain jurisdictions allow for a longer term. *See, e.g.*, BUS. CORP. § 704(a) (2010) (New York allows for a four year term); *see also,* N.J. REV. STAT. § 14A:6-4 (1) (2013) (directors can serve a five-year term before standing for reelection in New Jersey).

serving on a staggered board can be removed only for cause.[93] The requirement that directors can be removed only for cause is limited to corporations with staggered boards (it does not apply to corporations with non-staggered boards, whose directors can generally be removed without cause)[94] and means that mere dissatisfaction with the director's performance does not jeopardize her three-year tenure.[95] Thus, everything else being equal, a prospective director will prefer to serve on a board that is staggered.

Even though the controlling shareholder may not need the protection of the staggered board to entrench herself and make decisions for the dual-class firm, a staggered board may secure the directors and thus help the firm attract better director talent. For directors, improved job security may serve as a tradeoff for higher compensation. An outside director may be willing to accept a lower compensation than she would for serving on a non-staggered board, because the lower compensation would be coupled with the promise of a three-year term.

On the other hand, an effective staggered board confers a significant degree of control on the outside directors, which allows them to avoid being ousted (at least for three years) and also may prevent the sale of the company even if the controlling shareholder is interested in selling it.[96] Thus, if the board is structured as an effective staggered board and the directors gain significant power over the business and affairs of the company, the directors may also have the power to influence their own compensation, and may end up with higher pay.

To be sure, the aggregate directors' compensation of publicly traded firms, as high as it may be, is unlikely to add up to an amount that has a significant economic effect on such a firm.[97] However, the size of the directors' compensation may influence the behavior of the directors and the ability of the firm to attract talented directors.[98] In addition, it should be

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[93] DEL. CODE ANN. tit. 8, §141(k)(1) (2014) (subject to a provision to the contrary in the certificate of incorporation).

[94] *Id.*

[95] *Id.*

[96] This is because the directors can unilaterally adopt and maintain a poison pill that will prevent the acquisition of the company without the board's support. *See supra* Part II.B.3.

[97] *See, e.g.*, FREDERIC W. COOK & CO., INC., 2012 BOARD OF DIRECTORS COMPENSATION REPORT (2012), http://www.fwcook.com/alert_letters/2012_Directors_Compensation_Report_Non-Employee_Director_Compensation_Across_Industries_and_Size.pdf (reporting that the median total compensation for board services in large cap companies, companies with market capitalization greater than $5B, was $229,000).

[98] *Cf.* Robert Daines et al., *The Good, the Bad, and the Lucky: CEO Pay and Skill* (Univ. of Pa. Inst. for L. and Econ., Res. Paper Series, 2005),

noted that the motivation and ability of outside directors to significantly influence the performance of the firm may be constrained even if they are talented or paid relatively more than their peers, because of the power and influence of the CEO and a controlling shareholder.[99]

C. Foolproof Entrenchment

Another possible explanation for the combined use of dual-class capital structures and staggered boards is that incumbents, in search of a lasting entrenchment, may seek extra assurances. The cases of Facebook, Inc. and Google, Inc., discussed in this Part, may illustrate the perceived risk of relying on only one entrenchment mechanism. Similarly, the frequent calls to enhance corporate governance, de-stagger boards and restrict capital structures to one-share-one-vote, addressed at the end of this Part, provide an additional motivation for the incumbents to be unsatisfied with having only a dual-class or only a staggered board.

1. Facebook's Transition Mechanism—a Staggered Board as a Bench Player

The case of Facebook, Inc. and its founder and CEO, Mark Zuckerberg, for example, illustrates the perceived weakness of even the dual-class capital structure as a foolproof entrenchment mechanism. Facebook has a dual-class capital structure.[100] Mr. Zuckerberg owns shares of a class that is assigned superior voting rights—ten times as many votes, in fact, as the

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http://papers.ssrn.com/sol3/papers.cfm?abstract_id=622223 (studying the positive correlation between CEO pay and CEO skill and finding that the CEO equity based compensation is positively correlated with higher return on assets).

[99] *See,* Lucian A. Bebchuk & Jesse M. Fried, *Pay Without Performance: Overview of the Issues*, 30 J. CORP. L. 647, 655-56 (2005) ("Directors have had and continue to have various economic incentives to support, or at least go along with, arrangements that favor the company's top executives. A variety of social and psychological factors—collegiality, team spirit, a natural desire to avoid conflict within the board, friendship and loyalty, and cognitive dissonance—exert additional pull in that direction ...because the CEO has had significant influence over the nomination process, displeasing the CEO has been likely to hurt one's chances of being put on the company slate.... CEOs have influence over director compensation."); *but cf.* Marcel Kahan & Edward B. Rock, *Embattled CEOS*, 88 TEX. L. REV. 987, 987 (2010) (suggesting that there may be a "significant move away from the imperial CEO who was surrounded by a hand-picked board and lethargic shareholders.").

[100] Facebook, Inc., Registration Statement (Form S-1) 135 (Feb. 1, 2012), http://www.sec.gov/Archives/edgar/data/1326801/000119312512034517/d287954ds1.htm ("our restated certificate of incorporation provides for a dual class common stock structure").

shares of the other class.[101] Through the use of the dual-class capital structure and voting agreements, Mr. Zuckerberg controls 57% of the company's votes.[102]

Facebook's board of directors is not staggered.[103] The company's charter, however, includes a provision stating that the board of directors of the company will convert into a staggered board once Mr. Zuckerberg no longer controls the majority of the votes.[104] Thus, despite the dual-class capital structure of the company, the designers of its charter found it necessary to build in a mechanism to protect the incumbent should the dual-class capital structure fail to provide sufficient control. In the case of Facebook, Inc., the staggered board will serve as an automatic substitute for the dual class as an anti-takeover mechanism that entrenches the incumbent.

This case shows that a dual class, on its own, may not suffice because dilution—which may be practically inevitable as a firm grows and must issue more shares to raise capital[105]—may cause the controlling shareholder to lose her firm grip on the company, even though a dual class is considered one of the strongest entrenchment mechanisms.[106] This case also shows that a staggered board may be used, in the alternative, as part of several mechanisms such as a dual-class capital structure.[107] For Facebook, Mr. Zuckerberg's loss of control will trigger the restructuring of the board into a

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[101] *Id.* at 8 ("Shares of Class A common stock are entitled to one vote per share. Shares of Class B common stock are entitled to ten votes per share.").

[102] Ronald Barusch, *At Facebook, Governance = Zuckerberg*, WALL ST. J.: DEAL J. (Feb. 1, 2012, 7:49 PM), http://blogs.wsj.com/deals/2012/02/01/at-facebook-governance-zuckerberg/ ("Zuckerberg only owns about 28% of those super-voting Class B shares, so where does his control come from? He has voting agreements with many of his fellow shareholders that give him a proxy to vote enough additional shares to give him voting rights to a total of around 57% of the super-voting stock, the S1 shows. More than enough to give him control over the company."); Bigman, *supra* note 27
("[H]e owns about 18% of the company, but controls more than 50% of the voting power.").

[103] Facebook, Inc., *supra* note 100, at 135 ("Our board of directors will not initially be classified.").

[104] *Id.* at 32 ("when the outstanding shares of our Class B common stock represent less than a majority of the combined voting power of our common stock, our board of directors will be classified into three classes of directors with staggered three-year terms and directors will only be able to be removed from office for cause.").

[105] To be sure, the company may raise capital through debt issuances, which does not dilute the original shareholders' stakes in the company, but debt may be too expensive and may require excessively restrictive covenants.

[106] *See, e.g.*, Robert Daines & Michael Klausner, *Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs*, 17 J.L. ECON. & ORG. 83, 87 (2001) ("Dual class stock can make a hostile acquisition impossible.").

[107] *See CII* Urges, *supra* note 10.

staggered board.[108] In the case of the combined use of a dual class and a staggered board, however, the staggered board is already employed—standing by as an entrenchment mechanism should the dual class fail.[109] When opting for the combined use of the two mechanisms, it may be that the corporate planner did not consider the novel solution adopted by Facebook. Alternatively, the corporate planner might have dismissed the Facebook solution in favor of the combined use, which may appear even more secure since the board is already staggered. In particular, management that is anxious about hostile takeovers may favor the immediate formation of the staggered board, notwithstanding the existence of the dual class, in the same way that managements adopt poison pills in advance of any concrete threat of a hostile takeover even though they could delay the adoption as it does not require shareholder approval.[110] Thus, the reason for the combined use may not be an added virtue of each mechanism but rather the search for a long-lasting and secure entrenchment.

2. Google's Triple-Class Capital Structure

Additional anecdotal evidence illustrating the relative weakness of a dual-class capital structure not complemented with a staggered board can be seen in the case of Google, Inc. Google does not have a staggered board;[111] it does, however, have a dual-class capital structure.[112] The two founders of Google, Mr. Sergey Brin and recent CEO Mr. Larry Page,[113] own shares of the superior class of common stock that together afford them 56% of the

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[108] *Id.*

[109] *Id.*

[110] *See* Ganor, *supra* note 7, at 169 n.91 ("The existence of a poison pill indicates the board that chose to have a pill in place is currently anxious about hostile takeovers, even though a pill can be implemented at any time without the shareholders' approval.").

[111] Google, Inc., Registration Statement (Form S-1) 89 (Aug. 18, 2004), https://www.sec.gov/Archives/edgar/data/1288776/000119312504142742/ds1a.htm#toc59330_1

[112] *Id.* at 25 ("Our certificate of incorporation provides for a dual class common stock structure.").

[113] In late 2015, Google announced a corporate reorganization that resulted in a holding company structure in which the parent company was named Alphabet. *See, e.g.*, Conor Dougherty, *Google to Reorganize as Alphabet to Keep Its Lead as an Innovator*, N.Y. TIMES, Aug. 11, 2015, at A1, http://www.nytimes.com/2015/08/11/technology/google-alphabet-restructuring.html?_r=0 ("Under the new structure, Mr. Page is to run Alphabet along with Sergey Brin, who co-founded the web search business with him in 1998.").

voting power of the company despite owning only about 15% of the total shares.[114]

Knowing that the dual-class capital structure alone may not ensure continued control by Messrs. Brin and Page, since future issuances of stock will dilute their voting power, the company is planning an innovative entrenchment solution. Google, Inc. initiated a triple-class capital structure: adding a new class of shares—which has no voting rights—to the existing dual-class capital structure.[115] The use of a non-voting third class of shares when issuing new shares will allow the founders to retain their control of the company by preventing the dilution of their voting power.[116]

This case shows that the dual class alone may not suffice to ensure continued control and thus may lead a controlling shareholder to search for additional forms of protection.[117] The controlling shareholders at Google have pursued a triple-class capital structure to achieve the security that the dual-class capital structure failed to provide in the face of additional stock issuances.[118] Similarly, the staggered board may be used as the added protection that safeguards a controlling shareholder who may not be satisfied with the protection afforded by a dual-class capital structure alone.

3. *Shareholder Pressure and Calls for Corporate Governance Reform*

The Facebook and Google examples illustrate how a dual-class capital structure on its own, as potent as it is, may be insufficient for incumbents who wish to solidify their control and secure their entrenchment. In addition to the concern that the dual-class capital structure on its own may not adequately protect the incumbent, increased shareholder pressure and heightened public focus on corporate governance may motivate management to look for more than one entrenchment mechanism.[119] An arsenal of anti-takeover mechanisms may provide the incumbent management with better entrenchment—better than having just a staggered board or just a dual class—given public sentiment and pressures

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[114] *See, e.g.*, Michael Liedtke, *Google settles suit, clears way for stock split*, ASSOCIATED PRESS (Jun. 17, 2013, 8:55 PM), http://bigstory.ap.org/article/google-settles-suit-clears-way-stock-split.

[115] *Id.*

[116] *Id.* ("By creating a new class of non-voting shares, Google will be able to keep rewarding other employees with more stock and financing potential acquisitions of stock without undermining the voting power of Page and Brin.").

[117] *Id.*

[118] *Id.*

[119] *See* sources cited *supra* notes 9-10.

surrounding these anti-takeover mechanisms.[120] Both the dual-class capital structure and the staggered board have been under attack.[121]

Shareholder rights activists may focus their efforts where they can achieve the highest returns. Knowing that de-staggering a firm with a dual-class capital structure will not have a significant effect on the management's entrenchment, activists may not request a dual-class firm to de-stagger its board. Activists may perceive that attempting to dismantle two strong anti-takeover mechanisms is a losing proposition that simply is not worth the trouble. Thus, having multiple entrenchment mechanisms in place may not only ensure that if one mechanism is lost the others will remain in place, but it may also provide such deep entrenchment as to deter activist efforts to begin with.[122]

a) Recurrent Calls for One Share One Vote

In June 2013, Senator Elizabeth Warren appealed to the New York Stock Exchange and NASDAQ to consider barring initial public offerings of firms with dual-class capital structures.[123] Senator Warren argued that equal voting rights—which shareholder-rights activists have championed with the slogan "one-share-one-vote"[124]—is a basic right to which public investors should be entitled.[125] Citing the sharp increase in public companies with dual-class capital structures, Senator Warren stressed the urgency of her appeal.[126]

Senator Warren's appeal came at the heels of similar calls by organizations such as the Council of Institutional Investors (the CII).[127] The CII's call was motivated by concern about shareholders being hurt by capital structures with unequal voting rights.[128] These concerns also lead the

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[120] *Id.*

[121] *See, infra* Part IV.C.3.

[122] Indeed, studying the proxy solicitation firm Georgeson Shareholder's corporate governance reviews, this Study found no shareholder proposals to de-stagger boards of companies with dual class capital structures in the three years 2010-2012. There were three requests to eliminate the dual class capital structure in the same three-year period; yet, none of these companies had a staggered board. *See* GEORGESON, 2012 ANNUAL CORPORATE GOVERNANCE REVIEW (2013); GEORGESON, 2011 ANNUAL CORPORATE GOVERNANCE REVIEW (2012); GEORGESON, 2010 ANNUAL CORPORATE GOVERNANCE REVIEW (2011); GEORGESON, 2010 ANNUAL CORPORATE GOVERNANCE REVIEW (2011), http://www.georgeson.com/us/resource/Pages/acgr.aspx.

[123] Letter from Senator Warren, *supra* note 10.

[124] *Id.*

[125] *Id.*

[126] *Id.*

[127] *CII Urges*, *supra* note 10.

[128] *Id.* ("Concerned about the number of public multi-class stock companies and the resulting potential for harm to shareowners, the Council of Institutional Investors today urged the New York Stock Exchange and Nasdaq to make new companies that have two or more classes of common stock with unequal voting rights ineligible for listing.").

California Public Employees' Retirement System (CalPERS) to consider withholding investments in IPOs with unequal voting rights.[129]

It may well be unlikely that the U.S. stock exchanges will acquiesce to calls to bar dual class capital structures given the current competitive nature of their industry. In fact, historically the New York Stock Exchange only allowed dual class capital structures because of competitive pressure.[130] Even if the exchanges do not revise their listing rules, though, pressure from institutional investors may lead to changes in the rules and regulations governing securities offerings. At the end of the day, however, it is not a question of what is the likelihood that we will see a reversion to a mandatory single class capital structure; rather the question is the extent of the threat of this happening as it is perceived by the managers.

b) Dismantling Staggered Board Wave

In the beginning of 1999, about 60% of S&P 500 companies had a staggered board.[131] Shareholder pressure,[132] and recent concentrated efforts by the Harvard Law School's Shareholder Rights Project[133] have led to a dramatic decline in the number of large companies with staggered boards.[134] Today only about 10% of the S&P 500 companies have a staggered board.[135] Thus, in the presence of a wave to dismantle staggered

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[129] Eleanor Bloxham, *2013: A Year of Investor Class Warfare?*, FORTUNE (Dec. 6, 2012, 6:30 PM), http://fortune.com/2012/12/06/2013-a-year-of-investor-class-warfare/ ("CalPERS plans to take a close look at whether to set prohibitions for IPOs that have unequal shareholder voting rights . . . .").

[130] *See* Jeffrey N. Gordon, *Ties That Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CALIF. L. REV. 1, 5 (1988) ("The weakening competitive position of the NYSE in the provision of stock transaction services has put pressure on the exchange to abandon its single class common rule.").

[131] *See, e.g.*, LUCIEN BEBCHUK ET AL., *Toward Board Declassification in 100 S&P 500 and Fortune 500 Companies: Report of the SRP for the 2012 and 2013 Proxy Seasons* 9 (2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2400652 ("[T]here were 303 S&P 500 companies with classified boards at the beginning of 1999.").

[132] *See* Ganor, *supra* note 7 (finding an association between shareholder pressure and companies' decision to dismantle staggered boards).

[133] *See, e.g.*, Gretchen Morgenson, *New Momentum for Change in Corporate Board Elections*, N.Y. TIMES, July 7, 2013, at BU1, http://www.nytimes.com/2013/07/07/business/new-momentum-for-change-in-corporate-board-elections.html (the Harvard Law School's Shareholder Rights Project, or SRP, is a program that focuses on helping shareholders to dismantle staggered boards).

[134] *See, e.g.*, BEBCHUK ET AL., *supra* note 131, at 9 ("The work of SRP and SRP-represented investors during 2012 and 2013 has contributed to a substantial acceleration of the trend towards board declassification.").

[135] *Id.*

boards the entrenchment protection of the staggered board may seem illusory. Managers may no longer be content with the staggered board as the sole entrenchment mechanism.

The Facebook and Google examples described in subparts C(1) and C(2) above, respectively, and the shareholder pressure and calls for corporate governance reform hypothesis described under this subpart C(3) consider from a different angle the question of why firms might couple a dual-class capital structure and a staggered board.[136] Subparts C(1) and C(2) challenge the assumption that it is superfluous to have a dual-class capital structure and a staggered board; they hypothesize that deploying both mechanisms provides superior protection and that a dual class on its own may not be enough.[137] Subpart C(3), on the other hand, embraces the assumption that the dual-class capital structure and the staggered board are substitutes or functional equivalents for entrenchment purposes, and that the manager may be sufficiently protected with either—and thus may be satisfied with either—as long as she can be assured that she will not be stripped of whichever of the two mechanisms she chooses.[138]

D. An Apparent Corporate Governance Improvement

Public calls to improve corporate governance may put pressure on management to respond and show improvement. Starting with several anti-takeover mechanisms may leave room for "improvement" without totally relinquishing control. The combination of mechanisms, each potentially sufficient on its own, provides a currency for management, which it can use to show an "improvement" without losing significant control. Doing away with one of these mechanisms while leaving the other intact may serve as a kind of bone-throwing to the shareholders. Thus, using both a dual-class capital structure and a staggered board may help channel shareholder pressure and divert the shareholders' attention towards one of the mechanisms—a mechanism that is redundant and which the management therefore could do without.

The hypothesis described in subpart C(3) above focuses on public discontent with anti-takeover mechanisms and assumes that the combined use of dual-class capital structures and staggered boards stems from the management's fear of being forced to give up one of these anti-takeover defenses.[139] Thus, the motivation behind the combined use is to make sure that another mechanism is in place to protect management and ensure its continued entrenchment.[140] The hypothesis discussed under this subpart D

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[136] *See supra* Part IV.C.
[137] *Id.*
[138] *See supra* notes 103-21 and accompanying text.
[139] *See supra* Part IV.C.3.
[140] *See id.*

also focuses on public pressure, yet it assumes that shareholder pressure is not strong enough to force management to give up its entrenchment, and thus that it is not merely the fear of insufficient protection that motivates management. Rather, it is the opportunity to take advantage of the public sentiment and appear to be attentive to the public without weakening management security. This hypothesis contemplates a mechanism that enables management to gain from having both a dual class and a staggered board—and gain not just from the additional layer of antitakeover protection, but also from the apparent improvement of the corporate governance. When management strategically dismantles one of these two anti-takeover mechanisms, it hopes to score points with the shareholders.

The recent case of Whole Foods Market, Inc. (WholeFoods) may provide anecdotal evidence of companies ostensibly engaging in behavior that may be viewed as strategic—attempting to create the mere appearance of corporate governance improvement. WholeFoods was asked by a shareholder to include a shareholder proposal in its proxy material that would give large long-term shareholders proxy access.[141] Proxy access allows shareholders to list nominees for directorship positions on the company's ballots, which effectively challenges incumbent directors.[142] The shareholder proposal allowed shareholders holding at least 3% of the company's shares for no less than three years proxy access.[143] Instead, Wholefoods attempted to circumvent the proposal by asking the Securities and Exchange Commission to exclude it.[144] The grounds for exclusion were WholeFoods' own proposal that would similarly allow shareholder proxy access, however only a shareholder holding at least 5% of the company for five years would be eligible.[145] The higher percentage requirement would have rendered the shareholders' right to nominate directors virtually inaccessible, while WholeFoods would have appeared to allow shareholder proxy access.[146]

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[141] *See, e.g.*, Gretchen Morgenson, *In Whole Foods Backlash, a Chance to Air Out Stagnant Boardrooms*, N.Y. TIMES, Feb. 22, 2015, at BU1, http://www.nytimes.com/2015/02/22/business/in-whole-foods-backlash-a-chance-to-air-out-stagnant-boardrooms.html.

[142] *See, e.g., Proxy Access*, COUNCIL OF INSTITUTIONAL INVESTORS, http://www.cii.org/proxy_access (last visited Apr. 12, 2016).

[143] *See* Morgenson, *supra* note 141.

[144] *Id.*

[145] *Id.*

[146] *See, e.g.*, Paul Hodgson, *At Whole Foods, Chipotle, and Others, Shareholders Prepare for Battle*, FORTUNE (Feb. 3, 2015), http://fortune.com/2015/02/03/whole-foods-chipotle-proxy-access/ ("It's almost impossible, certainly unlikely, for a single shareholder to own 5% of any Fortune 500 company; 5% of Whole Foods is about $1 billion. The proposal was a clear spoiler, and was not intended to provide proxy access at all."); Morgenson, *supra* note 141 ("[S]ome investors viewed the proposal as a cynical attempt by Whole Foods to appear to give shareholders a say

To be sure, as in the case of WholeFoods, investors may see an apparent corporate governance improvement for what it is. And an efficient market will realize that management's disposing of only one strong anti-takeover mechanism while leaving another in place is not sufficient in terms of corporate governance reform. Yet, it may be viewed as the beginning of a process—a step in the right direction—and it may at the very least buy the manager precious time (in which she could continue to extract large private benefits from the company), since it is likely to take longer to dismantle both mechanisms. In any case, this hypothesis envisions the combination of dual-class capital structures and staggered boards as benefitting the incumbent by leaving at least one protection in place—if only for the time being.

V. TESTING THE HYPOTHESES

The preceding Part offered a few explanations for the seemingly superfluous use of both a dual-class capital structure and a staggered board. When considering the effect of this twofold protection on firm value, the explanations seem to exert forces in different directions: in favor of the controlling shareholder at the expense of the shareholders on the one hand, and in favor of the shareholders at the expense of the controlling shareholder on the other. This Part will examine these competing forces by empirically testing the effect of staggered boards on dual-class firms.

A. Firm Value and Firm Performance

In order to examine the incremental effect of a staggered board on a company, the Study started out by comparing the average firm value and firm performance of two subsets: (a) firms with both a dual class and a staggered board; and (b) firms with a dual class but without a staggered board.[147] The hypothesis tested is that in the case of the dual-class firm, the firm's value and performance is higher when the board is staggered because the staggered board curbs the powers of the controlling shareholder, allows the firm to hire better directors, and imparts continuity and stability to the board. The opposite hypothesis, tested simultaneously, conjectures that the value and performance of dual-class firms with staggered boards is lower despite the apparent benefits of having multiple classes of directors, because the negative aspects of the staggered board are overwhelming even

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in board elections while ensuring that they wouldn't, through the use of a high hurdle.").

[147] WRDS, https://wrds-web.wharton.upenn.edu/wrds/ (last visited Apr. 25, 2016). WRDS was used to access the Corporate Library datasets and the Standard and Poor's Institutional Market Services (Compustat) Database); *see Getting Started in Economics Research*, http://guides.library.harvard.edu/economics/wrds (last updated Dec. 8, 2015) (for a description of the datasets).

with a dual-class capital structure. Yet a third possibility is that the combined use of the two entrenching mechanisms, a staggered board and a dual-class capital structure, is superfluous (potentially driven by legal boilerplates) and thus the value and performance of firms in the two subsets is not significantly different.[148]

Put differently, this test asks whether the market rewards or penalizes companies for the combined use of a dual class and a staggered board (or is indifferent to it). Is firm performance negatively affected by the staggered board also in the context of the dual-class firm? To answer this question, the Study examined Tobin's Q, a widely used proxy for firm value and firm performance,[149] in a sample of U.S. firms with dual-class capital structures,[150] which included firms with and without a staggered board in 2010 and 2011. The final 2010-2011 sample consists of 332 observations.[151]

This study follows Bebchuk and Cohen's study of staggered boards.[152] Bebchuk and Cohen's study included only firms with a single-class.[153] Bebchuk and Cohen found a negative coefficient of about -0.2 and suggested that a staggered board decreases the firm's value in non-dual-class firms.[154] Replicating parts of the study on a sample of only dual-class firms may enhance the scope of the understanding of the staggered board and its efficacy.

Specifically, using the Corporate Library datasets and the Compustat Database, the Study collected financial data about active non-financial companies[155] with a dual-capital structure that were incorporated in the United States.[156] The Study calculated each firm's Tobin's Q and set it as the dependent variable in the study.[157] The explanatory variable of this

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[148] *See generally* John C. Coates IV, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 CALIF. L. REV. 1301 (2001) (explaining variation in defenses by characteristics of the advising lawyers).

[149] *See, e.g.,* Bebchuk & Cohen, *supra* note 7, at 419.

[150] WRDS, *supra* note 147.

[151] *See infra* Table II.

[152] *See generally*, Bebchuk & Cohen, *supra* note 7.

[153] *Id.*

[154] *Id.* at 18-9.

[155] Financial companies are subject to different regulations. *See, e.g.,* Bebchuk & Cohen, *supra* note 7, at 418 (excluding REITs from the sample because such corporations "have their own special governance structure and entrenching devices"); Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525, 530 (2001) (omitting financial firms from the tested sample because the special federal regulations may influence the corporate governance of such firms).

[156] WRDS, *supra* note 148.

[157] Tobin's Q is the ratio of the market value of assets to replacement cost of assets. *See* Steven Kaplan & Luigi Zingales, *Do Investment-Cash Flow Sensitivities Provide Useful Measures of Financing Constraints?*, Q.J. ECON. 112, 169–216

study is a dummy variable[158] that indicates whether or not the firm has an effective staggered board.[159] The Study looked for a linear relation between the log[160] of the Tobin's Q (Log(Tobin'sQ)) and an effective staggered board dummy variable (EffectiveStaggeredBoard), controlling for various firm characteristics and assuming the following relation:[161]

Log(Tobin'sQ) = α + β1 (EffectiveStaggeredBoard) + β2 Log(Size) + β3 (Industry) + (other variables).

B. Control Variables and Robustness Checks

The study's empirical results are robust and are not weakened by the inclusion of additional controls for variables that might affect a corporation's performance. The correlation between the effective staggered board structure and the performance of the firm is significant in the multi-variable regressions that take into account these additional effects.[162]

Some variables may affect both the Tobin's Q of the firm (the dependent variable) and the structure of the board (the explanatory variable). Thus, including these variables as controls in a multi-variable regression helps isolate the direct connection between the explanatory variable and the dependent variable. For example, certain industries may perform better than the market at particular times and may also follow a norm of structuring the board in a certain way (with or without a staggered board.) Thus, checking the correlation between the performance of the firm and the structure of the board without controlling for the industry in which the firm operates will provide a biased result that will include the industry

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(1997); Paul Gompers et al., *Corporate Governance and Equity Prices,* Q.J. ECON. 118, 107–55 (2003); Lucian Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?*, 90 CALIF. L. REV. 1775, 1775–821 (2002); Bebchuk & Cohen, *supra* note 7, at 409-33. I measure Tobin's Q as the ratio of (1) the sum of the book value of assets plus the market value of common stock minus the sum of book value of common stock and balance sheet deferred taxes, and (2) the book value of assets. *See* Lucian A. Bebchuk et al., *supra* note 2, at 800.

[158] A dummy variable is a binary variable that takes the values of 0 or 1, and indicates to which of two categories the observation is classified. *See, e.g.,* William Gould, *Creating Dummy Variables*, STATA, (Mar. 1997), http://www.stata.com/support/faqs/data-management/creating-dummy-variables/.

[159] *See, e.g.*, Bebchuk et al., *supra* note 2, at 894.

[160] The logarithm function is used throughout because when we look at the log of monetary values the effect of inflation becomes an additive constant once the log is taken: $log[X(1+i)] = log(X) + log(1+i)$, where X is the monetary value and i is the inflation rate. In addition, the log transformation is used to prevent bias towards very large companies.

[161] *Cf.,* Bebchuk & Cohen, *supra* note 7, at 17 (studying the association between staggered boards and firm value on firms without dual-class).

[162] *See infra* Tables II-VI.

effects. Thus, as control variables the Study included the total assets of the firm (as Log(Size)), the firm's market value (as Log(MarketValue)), the main industry in which the firm operates (based on the Fama-French 12 industry sectors). The Study also added to the regression $Log(Size)^2$ and $Log(MarketValue)^2$ to control for nonlinearity in the relationship of Log(Tobin'sQ) to Log(Size) and Log(MarketValue).[163] Founder firms, firms whose founder serves as the CEO or chairman of the board,[164] form a special case of corporate governance and agency relationship, which are likely to involve different agent motivations.[165] Thus, in the various regressions ran in this Study, such firms were either excluded from the sample or this special characteristic was controlled for by including both a dummy variable for a founder firm and an interaction variable (the founder firm dummy variable multiplied by the independent dummy variable EffectiveStaggeredBoard).[166] For example, the regressions of which results are reported in Table III below include control variables for founder firms.[167]

Family firms, firms that are controlled by multiple members of a single family,[168] may also give rise to special concerns. In particular, concerns about a few family members defecting from the family consensus and joining forces with the hostile bidder may weaken the dual-class capital structure's ability to offer an impenetrable entrenchment defense. Thus, in the setting of a family firm, coupling the dual class with a staggered board may enhance management entrenchment.[169] However, a family agreement may secure the entrenchment of the family and prevent defectors from circumventing the dual-class capital structure defense even without a

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[163] *See infra* Table I.

[164] *Id.*

[165] *See, e.g.*, Liedtke, *supra* note 114 (for the case of Google and its founders, Messrs. Page and Brin).

[166] When we have a sample that includes observations that fall into two categories, performing a regression on each category separately, and thus allowing for the constant and the coefficients of each category to be different will reveal the unique connections within each category. This is mathematically equivalent to adding a dummy variable together with all its interactions with all the independent variables. Sometimes, however, this is impractical, because it would reduce the degrees of freedom excessively, and in such cases one omits the interaction variables. But in this case, one implicitly assumes that the coefficients do not vary much between categories. However, it is always preferable to take the first approach if the number of observations is sufficient. *See, e.g.*, Mira Ganor, *Agency Costs In The Era of Economic Crisis: The Enhanced Connection Between CEO Compensation and Corporate Cash Holdings*, 55 ARIZ. L. REV. 106, 115 n.62 (2013).

[167] *See infra* Table III.

[168] *See infra* Table I.

[169] *Cf.*, Barzuza, *supra* note 57, at 982 (proposing that a firm's status as a family firm may influence the choice to incorporate under Nevada law rather than Delaware law, because the latter "may be especially costly for family firms.").

staggered board.[170] Such agreements restrict share transfers and govern the voting of the family members.[171] Nonetheless, the Study included a control variable for family firms in the regression reported in Table VI below.

The Study also included the following corporate governance variables. A dummy variable that indicates whether or not the majority of the firm's outstanding shares are held by institutional investors (InstitutionalMajority); The percentage of shares held by top management, directors, and 5% or greater shareholders (InsiderPlusPctg); A dummy variable indicating whether the firm is incorporated in the state of Delaware (DelawareIncorporation); and a dummy variable that indicates whether the firm has a staggered board that is not effective (IneffectiveStaggeredBoard). A variable that measures the percentage of outside directors by calculating the percentage of directors of the firm who are fully independent, neither serve as executives of the firm nor have or have had a significant relationship with the firm (%DirectorsOutside) was also included. The percentage of outside directors may play a special role in a sample consisting of dual class firms. Generally, both the NYSE and NASDAQ require that the board of directors of listing companies include a majority of independent directors.[172] However, controlled companies (defined as a company of which the majority of the voting power is held by an individual, a group or another company) are exempt from the majority board independence requirement.[173]

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[170] *See, e.g.*, The E.W. Scripps Co., Proxy Statement (Schedule 14A) at 42 (March 28 2011), http://www.sec.gov/Archives/edgar/data/832428/000095012311029653/l41563def14a.htm. The Scripps family agreement entered among members of the Scripps family and The E.W. Scripps Company, which requires each member to vote her shares in accordance with the decision of the family members who hold the majority of the family's votes and restricts transfer of shares. To prevent circumventing the agreement, it provides, inter alia, that "[a]ny valid transfer of Common Voting Shares made by Signatories without compliance with the Scripps Family Agreement will result in automatic conversion of such shares to Class A Common Shares" which have limited voting rights and cannot elect the majority of the board. *Id.*

[171] *Id.*

[172] NYSE Inc., Listed Company Manual § 303A.04 (2014), http://nysemanual.nyse.com/lcm/sections/lcm-sections/chp_1_4/default.asp; NASDAQ Inc., Stock Market Listing Rules § 5615-4(c)(2) (2014), http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.asp?selectednode=chp_1_1_4_3_8_16&manual=%2Fnasdaq%2Fmain%2Fnasdaq-equityrules%2F.

[173] *Id.*

C. Effective Dual-Class Capital Structure

As described in *Supra* Part I.A., a dual-class capital structure may provide an impenetrable defense against a hostile takeover.[174] However, not every dual-class capital structure actually provides entrenchment to the incumbents. For example, a company may have a dual-class capital structure that assigns identical or similar rights to the shares of each of the two classes, pairing control rights with economic interest with no real deviation from a single-class capital structure.[175] Furthermore, even if the capital structure of the company assigns disproportionately superior voting rights to one class than to the other class, the dual-class capital structure may still fail to secure the incumbent. A dual-class capital structure may serve as a strong entrenchment mechanism only if the incumbents have the right to cast enough votes to control the company. For example, if the superior class has ten times more votes per share than the other, inferior, class but there are more than ten times as many shares of the inferior class then, as a group, the inferior class controls the majority of the votes of the company. Suppose there are two classes of shares: Class A and Class B. Class A shares have 10 votes per share while Class B shares have 1 vote per share. If there are only 10 shares of Class A and 101 shares of Class B, then Class A has a total of 100 votes (10 shares times 10 votes), while Class B has a total of 101 votes (101 shares times 1 vote). Thus, even with a dual-class capital structure there has to be a shareholder who owns a sufficient number of shares that gives her enough votes to defeat a hostile takeover attempt. In addition, the structure of dual-class firms may vary not just with respect to the number of votes assigned to each class of shares for voting on shareholder resolutions but also in the assignment of special class rights to nominate and elect board members or to veto merger transactions. If, for example, the company's charter allows a single class to elect the majority of the directors, regardless of its voting rights with respect to other shareholder decisions, then this right may well entrench the incumbents.[176]

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[174] *See supra* Part II.A.

[175] *See, e.g.,* THERAVANCE, INC., Proxy Statement (Schedule 14A) 1 (March, 2011), http://www.sec.gov/Archives/edgar/data/1080014/000104746911002231/a2202591zdef14a.htm ("[T]he Class A Common Stock is entitled to vote with the Common Stock... The holders of Common Stock and the holders of Class A Common Stock each have the right to one vote for each share they held as of the record date.").

[176] *See, e.g.,* Dillard's Inc., Proxy Statement (Schedule 14A) 1 (May, 2009), http://www.sec.gov/Archives/edgar/data/28917/000119312509083518/ddef14a.htm ("[E]ach holder of Class A Common Stock and each holder of Class B Common Stock shall be entitled to one vote on the matters presented at the meeting for each share standing in his name except that the holders of Class A Common Stock are empowered as a class to elect one-third of the Directors and the holders of Class B Common Stock are empowered as a class to elect two-thirds of the Directors.").

Thus, in order to check the effect of the staggered board on companies with dual-class capital structures that provide a meaningful and strong entrenchment, the companies in the sample need to have an effective dual-class capital structure, a structure that de facto provides entrenchment to the management or a controller. For robustness, the dual-class capital structure of each of the companies in the sample was examined using the company's proxy statement filings with the Securities and Exchange Commission.[177] For example, some dual-class firms have one individual who controls the entire shareholder voting power while the publicly traded stock has no voting power.[178] On the other hand, there are firms that use the dual-class structure only to secure a minimal representation of special interest groups on the board but not to confer control to any shareholder or the management, such as the case of United Continental Holdings Inc. which uses the dual-class structure to allow the labor unions to have minimal representation on the company's board of directors.[179] Even when the dual-class structure assigns to the management less than the majority of the shareholder votes, management may still be fully entrenched due to other specific arrangements. Such arrangements include a super majority requirement on business combinations.[180] This requirement stipulates that a higher percentage than a simple 50% majority (for example, 70%) of the votes approves the transaction, thus granting a veto right to the holder of less than the majority of the shares (in this example the holder of only 30% of the vote).[181] Similarly, management may have less than 50% of the

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[177] *See EDGAR, Company Filings,* U.S. SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/edgar/searchedgar/companysearch.html (last visited Apr. 12, 2016).

[178] *See, e.g.,* EZCORP, Inc., 2011 Annual Report (Form 10-K) 19 (Nov. 23, 2011), http://www.sec.gov/Archives/edgar/data/876523/000095012311100270/d84374e10vk.htm ("One person beneficially owns all of our voting stock and controls the outcome of all matters requiring a vote of stockholders[.]").

[179] *See, e.g.*, United Continental Holdings, Inc., 2014 Proxy Statement (Schedule 14A) 16-17 (April, 2014), http://www.sec.gov/Archives/edgar/data/100517/000104746914004198/a2219797zdef14a.htm (the dual-class structure allows the mechanics union and pilots union to elect one director each out of a total of 13 directors).

[180] *See* Lucian Bebchuk, et al., *What Matters in Corporate Governance*, 22 REV. FIN. STUD. 783 (2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=593423##.

[181] These arrangements also include veto rights that require the consent of a class of stock for certain fundamental transactions even though the class represents less than the majority of the votes of the company. *See, e.g.*, Sirius XM Radio Inc., 2011 Proxy Statement (Schedule 14A) 2, 20 (April, 2011), http://www.sec.gov/Archives/edgar/data/908937/000095012311034969/y90785def14a.htm ("[H]olders of our Series B-1 Preferred Stock held approximately 40% of the general voting power. ... [W]e need the consent of the holder of the Series B-1

nominal shareholder voting rights, but nonetheless, possess the majority of the voting power because certain shares are excluded from the vote as they are owned indirectly by the company.[182]

The Study defined a subset of the sample that consisted of dual class companies of which the members of the board, as a group, had the right to cast at least the majority of the shareholder votes, or the right to nominate the majority of the board members or veto a merger, or had a controlling shareholder.[183] This threshold of inclusion in the subset sample, which requires more than 50% of the votes, may well be conservative since the incumbents who hold the right to cast less than 50% of the votes may still control the fate of the firm. An incumbent who controls 45% of the votes of a publicly traded company with a dispersed shareholder base, for example, may well possess de facto control over the company and be safely entrenched even though her capital holdings fall short of the 50% threshold. The Study reran the regression with the subset of only the effective dual class firms, losing about a third of the original sample.[184] To be sure, with less statistics the significance of the results declined (though still statistically significant at more than the 90% level), yet the results came out similar: an effective staggered board is negatively correlated with the performance of the company, measured by Tobin's Q, also in the sample consisting of only effective dual class firms, as is described in Table V below.[185]

D. Results and Analysis

The results of the OLS regressions are listed in tables at the end of this Article. The tables differ by the various controls that were included, but they portray a similar picture. In particular, the results of the OLS regression for 2010-2011 run together as a time series, reported in Table II below, suggest that: Log(Tobin's Q) = (1.76±0.34) + (-0.09±0.03) (EffectiveStaggeredBoard) + Controls + (statistical error).[186] The Study finds that an effective staggered board is negatively correlated with the

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Preferred Stock for certain actions, including: . . . any merger or consolidation, or any sale of all or substantially all of our assets . . . .").

[182] *See, e.g.*, The Journal Communications, Inc., 2009 Proxy Statement (Schedule 14A) 13 (March, 2009), http://www.sec.gov/Archives/edgar/data/1232241/000119312509058589/ddef14a.htm ("The Journal Company is our wholly owned subsidiary. Pursuant to applicable state law, the shares of class B common stock held by The Journal Company are not entitled to vote".); *see* DEL. CODE ANN. tit. 8, § 160(c) (2013).

[183] *See infra* Table V.

[184] *Id.*

[185] *Id.*

[186] *See infra* Table II.

performance of firms with dual-class capital structures. This result, which is statistically significant at above the 99% level, suggests that if a board of a firm with a dual-class capital structure has an effective staggered board, then on average the firm's Tobin's Q will be about 19% lower.

Further support to the findings of this Article and expansion to previous years can be derived from the application of a few of the reported findings of a comprehensive study by Olubunmi Faleye to the questions raised in this Article.[187] Similarly to Bebchuk and Cohen,[188] Faleye studied staggered boards and found a negative relation with firm value in the seven-year period starting from 1996 through 2002.[189] Faleye tested the sensitivity of his results with respect to staggered boards using a dozen anti-takeover defenses as controls.[190] Relevant to the questions raised in this Article is the fact that one of the anti-takeover defenses that Faleye used as controls in these sensitivity tests was the dual-class capital structure.[191] Faleye concluded from the results of the sensitivity tests that "the negative effect of classified boards on firm value is not driven by other takeover defenses,"[192] yet he did not question the management entrenchment explanation for the staggered board in the presence of a dual-class capital structure.[193] However, from the results of Faleye's study, reported in table 3 of his paper, one can learn that in the years 1996-2002 the firm value of dual-class firms was lower when the board was staggered.[194] The sum of the coefficients of the staggered board and an interaction variable between a staggered board and a dual-class capital structure, reported in Faleye's study, is negative and indicates a 6.64 percentage point decrease in Tobin's Q (with a standard deviation of 0.028).[195]

Finally, it should be noted that, as with prior studies of staggered boards in single-class firms, causality cannot be inferred with certainty.[196] However, this Article's goal is not to prove causality, but rather to enhance our understanding of staggered boards by shedding light on the special case of the dual-class firm that deploys a staggered board despite the prominent entrenchment attribute of the dual-class capital structure.

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[187] *See generally* Faleye, *supra* note 50.
[188] *See* Bebchuk & Cohen, *supra* note 7.
[189] *See* Faleye, *supra* note 50, at 502.
[190] *Id.* at 511.
[191] *Id.*
[192] *Id.* at 514.
[193] *See generally* id.
[194] *Id.* at Table 3: Classified boards, other takeover defenses, and firm value.
[195] *See* Faleye, *supra* note 50, at 512.
[196] *See generally id.*; Cohen & Wang, *supra* note 50.

VI. CONCLUSION

At the center of the corporate governance of the company is the choice of anti-takeover mechanisms a company decides to adopt and is associated with various key aspects of the company such as the company's value, shareholder pressure, agency costs, managerial entrenchment and tenure. The choice of whether or not to deploy a staggered board, one of the most potent anti-takeover mechanisms, is substantial and deserves the concentrated attention it has been given by academics and practitioners. The isolation of this choice from its context, however, may be obscuring. Thus, in order to further the understanding of staggered boards, and more generally the understanding of the corporate governance choices companies make, this Paper focuses on a combination of anti-takeover mechanisms that has been largely dismissed and discarded in previous studies: staggered boards and dual class capital structures.

The existence of this combination is, in itself, revealing: even though each one of these mechanisms is commonly believed to entrench management effectively, a number of companies, nonetheless, chose to deploy both mechanisms.[197] The results of the empirical studies reported in this Paper are even more revealing: the presence of a staggered board along with a dual class capital structure is associated with lower firm performance (as measured by Tobin's Q). While this finding does not shine a positive light on staggered boards, it questions the conventional wisdom that views the staggered board as a sufficient entrenchment mechanism that secures management and allows it to shirk and extract private benefits.

[197] *See infra* Table I.

TABLE I: DESCRIPTION OF THE VARIABLES USED IN THE REGRESSION MODELS

A list of some of the control variables used in the regressions and their respective definitions in the applicable databases.

Control Variables	Definition
%DirectorsOutside	The percentage of directors of the firm who are fully independent, neither serve as executives of the firm nor have or have had a significant relationship with the firm.
Delaware Incorporation	A dummy variable indicating whether the company is incorporated under the laws of the state of Delaware.
EffectiveStaggered Board	A dummy variable indicating whether the company has a staggered board that a hostile bidder cannot dismantled without gaining control of the board.
FamilyFirm	A dummy variable indicating whether the company is controlled by multiple members of a single family.
Founder Firm	A dummy variable indicating whether the founder of the company serves as the CEO or chairman of the board of the company.[198]
IndustrySector #	The firm's industry based on the Fama-French 12 industry sectors.
IndustrySector 1	Consumer Non-Durables—Food, Tobacco, Textiles, Apparel, Leather, Toys
IndustrySector 10	Healthcare, Medical Equipment, and Drug
IndustrySector 12	Other—Mines, Constr, BldMt, Trans, Hotels, Bus Serv, Entertainment
IndustrySector 2	Consumer Durables—Cars, TV's, Furniture, Household Appliances
IndustrySector 3	Manufacturing—Machinery, Trucks, Planes, Off Furn, Paper, Com Printing
IndustrySector 4	Energy—Oil, Gas, and Coal Extraction and Products
IndustrySector 5	Chemicals and Allied Products
IndustrySector 6	Computers, Software, and Electronic Equipment
IndustrySector 7	Telephone and Television Transmission
IndustrySector 9	Wholesale, Retail, and Some Services (Laundries, Repair Shops)
IneffectiveStaggered Board	A dummy variable indicating whether the company has a staggered board that does not amount to an effective

[198] *See* Kenneth R. French, *Data Library*, http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html (last visited Apr. 12, 2016).

	staggered board.
InsidersPlusPctgShares	The percentage of shares held by top management, directors, and 5% or greater shareholders.
InstitutionalMajority	A dummy variable that indicates whether the majority of the firm's outstanding shares are held by institutional investors.
MarketValue	Market value (MKVALT)
Size	Total Asset
Tobin'sQ	Tobin's Q, the market value of assets to replacement cost of assets, the ratio of (1) the sum of the book value of assets plus the market value of common stock minus the sum of book value of common stock and balance sheet deferred taxes, and (2) the book value of the assets.
Year	Indicates the year of the observation. YEAR=1 refers to data from 2011 while YEAR=0 refers to data from 2010.

TABLE II – FIRM VALUE AND EFFECTIVE STAGGERED BOARDS WITH A DUAL-CLASS CAPITAL STRUCTURE WITH ROBUST CLUSTERING AND INTERACTIONS BETWEEN YEAR AND INDUSTRY

The dependent variable in the regressions is the log of the firm's Tobin's Q. Tobin's Q is the ratio of the market value of assets to replacement cost of assets. Size is the value of the total assets of the firm. [Description of the additional variables is available in Table I above] The data was taken from Compustat and the Corporate Library databases and does not include financial firms and founder firms.[199] The Arellano test (firm, year) was used for the calculation of White's heteroskedasticity-consistent covariance matrix.[200] (t-statistic is reported in parentheses. The notations ***, **, * indicate significance at the 99%, 95%, and 90% levels respectively.)

Dependent Variable: Log(Tobin'sQ)		**2010 -2011**	
Variable	Beta (t-statistics)	Variable	Beta (t-statistics)
Intercept	1.75729850 (5.1599)***	Year	0.00024315 (0.0329)
EffectiveStaggeredBoard	-0.09171169 (-3.1884)***	Year*Industry 1	0.00908541 (0.8306)
Industry 1	-0.01641304 (-0.5203)	Year*Industry 2	0.01737740 (0.7021)
Industry 2	-0.02873632 (-0.6558)	Year*Industry 3	0.02858408 (1.6125)

[199] WRDS was used to access the Corporate Library datasets and the Compustat Database. *See* sources cited *supra* note 147.

[200] *See* Arellano, M., *Computing Robust Standard Errors for Within-groups Estimators*, 49 OXFORD BULL. ECON. AND STAT. 431, 431-34 (1987).

Industry 3	-0.03514412 (-0.9695)	Year*Industry 4	0.02910354 (1.3078)
Industry 4	-0.00254329 (-0.0633)	Year*Industry 5	0.01593088 (0.7819)
Industry 5	0.05074203 (0.6535)	Year*Industry 6	-0.03061758 (-1.0581)
Industry 6 (tech)	-0.06429337 (-1.6367)	Year*Industry 7	-0.00811520 (-0.6306)
Industry 7	0.01729698 (0.5387)	Year*Industry 8	-0.01082972 (-0.8446)
Industry 8	-0.03900584 (-1.0420)	Year*Industry 9	0.01134862 (1.0272)
Industry 9	-0.01439985 (-0.4211)	Year*Industry 10	0.00539140 (0.2177)
Industry 10	-0.01433567 (-0.1924)		
LOG(Size)	-1.01382925 (-3.9835)***		
InsidersPlusPctgShares	0.01758137 (0.5180)		
%DirectorsOutside	-0.01058924 (-0.1901)		
IneffectiveStaggeredBoard	0.00625377 (0.3195)		
InstitutionalMajority	-0.00401470 (-0.4372)		
Log(MarketValue)	0.05647171 (0.3531)		
Log(MarketValue)^2	0.05175835 (2.0868)**		
LOG(Size)^2	0.09036424 (2.2252)**		
Delaware Incorporation	0.03334949 (1.6992) *		
N	332		

TABLE III – ROBUSTNESS TESTS – FIRM VALUE AND EFFECTIVE STAGGERED BOARDS WITH A DUAL-CLASS CAPITAL STRUCTURE INCLUDING FOUNDER FIRMS

The dependent variable in the regressions is the log of the firm's Tobin's Q. Tobin's Q is the ratio of the market value of assets to replacement cost of assets. Size is the value of the total assets of the firm. [Description of the additional variables is available in Table I above.] The data was taken from Compustat and the Corporate Library databases and does not include financial firms.[201] (t-statistic is reported in parentheses.

[201] WRDS was used to access the Corporate Library datasets and the Compustat Database. *See* sources cited *supra* note 147.

The notations ***, **, * indicate significance at the 99%, 95%, and 90% levels respectively.)

Dependent Variable: Log (Tobin'sQ)	**2010**	**2011**
Variable	Beta (t-statistics)	Beta (t-statistics)
Intercept	1.01692 (4.67)***	0.88119 (4.64)***
EffectiveStaggeredBoard	-0.08190 (-2.19)**	-0.06797 (-2.06)**
Industry 1	-0.01975 (-0.56)	-0.01822 (-0.55)
Industry 2	-0.03634 (-0.55)	-0.03984 (-0.68)
Industry 3	-0.01763 (-0.41)	-0.01529 (-0.38)
Industry 4	-0.03447 (-0.51)	-0.00347 (-0.06)
Industry 5	0.09233 (1.37)	0.04421 (0.69)
Industry 6 (tech)	0.04032 (0.93)	-0.07003 (-2.05)**
Industry 7	0.04671 (1.26)	0.01685 (0.49)
Industry 8	-0.05865 (-0.69)	-0.07794 (-1.09)
Industry 9	-0.00930 (-0.24)	-0.01149 (-0.34)
Industry 10	0.04515 (0.88)	0.04794 (1.01)
LOG(Size)	-0.43205 (-3.10)***	-0.46390 (-3.41)***
InsidersPlusPctgShares	-0.08856 (-1.73)*	-0.05108 (-1.15)
%DirectorsOutside	-0.05700 (-0.74)	-0.11427 (-1.71)*
IneffectiveStaggeredBoard	-0.02456 (-0.95)	-0.01535 (-0.64)
InstitutionalMajority	-0.05150 (-2.15)**	-0.00792 (-0.39)
Log(MarketValue)	0.01970 (0.19)	0.12906 (1.21)
Log(MarketValue)^2	0.06078 (3.46)***	0.04424 (2.49)**
LOG(Size)^2	-0.00079 (-0.03)	0.00628 (0.28)
Delaware Incorporation	0.03555 (1.52)	0.00414 (0.21)
Founder Firm	-0.01864 (-0.50)	-0.04578 (-1.47)
Founder Firm* EffectiveStaggeredBoard	0.04532 (0.48)	0.18083 (1.73)*
N	180	204

TABLE IV – ROBUSTNESS TESTS – FIRM VALUE AND EFFECTIVE STAGGERED BOARDS WITH A DUAL- CLASS CAPITAL STRUCTURE – FOUNDER FIRMS OMITTED

The dependent variable in the regressions is the log of the firm's Tobin's Q. Tobin's Q is the ratio of the market value of assets to replacement cost of assets. Size is the value of the total assets of the firm. [Description of the additional variables is available in Table I above.] The data was taken from Compustat and the Corporate Library databases and does not include financial firms. (t-statistic is reported in parentheses. The notations ***, **, * indicate significance at the 99%, 95%, and 90% levels respectively.)

Dependent Variable: Log(Tobin'sQ)	**2010**	**2010**	**2011**	**2011**
Variable	Beta (t-	Beta (t-	Beta (t-	Beta (t-
Intercept	0.17984 (10.03)***	1.04568 (4.62)***	0.15933 (9.68)***	1.09039 (5.40)***
EffectiveStaggeredBoard	-0.04063 (-0.71)	-0.07756 (-2.13)**	-0.01813 (-0.36)	-0.06954 (-2.15)**
Industry 1		-0.02901 (-0.82)		-0.02076 (-0.62)
Industry 2		-0.03861 (-0.61)		-0.03891 (-0.68)
Industry 3		-0.03358 (-0.81)		-0.02568 (-0.62)
Industry 4		-0.03712 (-0.59)		-0.01164 (-0.20)
Industry 5		0.04926 (0.84)		0.04682 (0.74)
Industry 6 (tech)		-0.04091 (-0.88)		-0.07311 (-2.01)**
Industry 7		0.01553 (0.45)		-0.00377 (-0.11)
Industry 8		-0.07546 (-0.94)		-0.09167 (-1.30)
Industry 9		-0.01274 (-0.32)		-0.02241 (-0.63)
Industry 10		-0.01423 (-0.24)		0.04960 (0.92)
LOG(Size)		-0.64110 (-4.66)***		-0.51160 (-3.77)***
InsidersPlusPctgShares		-0.11563 (-2.27)**		-0.04430 (-0.97)
%DirectorsOutside		-0.12853 (-1.64)		-0.14464 (-2.08)**
IneffectiveStaggeredBoard		-0.04747 (-1.79)*		-0.01582 (-0.62)

InstitutionalMajority		-0.04567 (-1.87)*		-0.01150 (-0.54)
Log(MarketValue)		0.25902 (2.18)**		0.05923 (0.52)
Log(MarketValue)^2		0.02030 (1.05)		0.04996 (2.60)**
LOG(Size)^2		0.03558 (1.56)		0.01768 (0.78)
Delaware Incorporation		0.02579 (1.08)		0.00611 (0.29)
N	175	153	182	179
Adjusted R-squared		0.6631		0.6392

TABLE V – FIRM VALUE AND EFFECTIVE STAGGERED BOARDS WITH AN EFFECTIVE DUAL-CLASS CAPITAL STRUCTURE WITH ROBUST CLUSTERING AND INTERACTIONS BETWEEN YEAR AND INDUSTRY

The dependent variable in the regressions is the log of the firm's Tobin's Q. Tobin's Q is the ratio of the market value of assets to replacement cost of assets. Size is the value of the total assets of the firm. [Description of the additional variables is available in Table I above.] The data was taken from Compustat and the Corporate Library databases and does not include financial firms and founder firms. The Arellano test (firm, year) was used for the calculation of White's heteroskedasticity-consistent covariance matrix. (t-statistic is reported in parentheses. The notations ***, **, * indicate significance at the 99%, 95%, and 90% levels respectively.)

Dependent Variable: Log(Tobin'sQ)		**2010 -2011**	
Variable	Beta (t-statistics)	Variable	Beta (t-statistics)
Intercept	1.14686683 (2.3415)**	Year	-0.00010554 (-0.0104)
EffectiveStaggeredBoard	-0.07831717 (-1.8090)*	Year*Industry 1	0.00064340 (0.0487)
Industry 1	-0.01832896 (-0.4863)	Year*Industry 2	-0.02406881 (-1.7481)*
Industry 2	-0.04481484 (-1.1624)	Year*Industry 3	0.01865264 (1.0295)
Industry 3	-0.04725125 (-1.2172)	Year*Industry 5	0.03382091 (1.2848)
Industry 5	0.06891798 (0.6646)	Year*Industry 6	-0.01192020 (-0.3434)
Industry 6 (tech)	-0.06296404 (-1.1658)	Year*Industry 7	0.00158810 (0.1169)
Industry 7	-0.00125837 (-0.0346)	Year*Industry 8	-0.01540984 (-1.4592)
Industry 8	-0.03133138 (-0.5814)	Year*Industry 9	0.01898866 (1.1924)

Industry 9	-0.04619909 (-1.1898)	Year*Industry 10	-0.00823696 (-0.1970)
Industry 10	0.04126813 (0.4801)		
LOG(Size)	-0.62278203 (-1.7102)*		
InsidersPlusPctgShares	0.04862705 (1.1431)		
%DirectorsOutside	-0.05278467 (-0.9814)		
IneffectiveStaggeredBoard	-0.02996607 (-0.9997)		
InstitutionalMajority	-0.01033879 (-0.8827)		
Log(MarketValue)	0.02322583 (0.1396)		
Log(MarketValue)^2	0.05782991 (2.1729)**		
LOG(Size)^2	0.03762242 (0.6508)		
Delaware Incorporation	-0.00405955 (-0.1843)		
N	202		

TABLE VI – FAMILY FIRM CONTROLS - FIRM VALUE AND EFFECTIVE STAGGERED BOARDS WITH AN EFFECTIVE DUAL-CLASS CAPITAL STRUCTURE WITH ROBUST CLUSTERING AND INTERACTIONS BETWEEN YEAR AND INDUSTRY

The dependent variable in the regressions is the log of the firm's Tobin's Q. Tobin's Q is the ratio of the market value of assets to replacement cost of assets. Size is the value of the total assets of the firm. [Description of the additional variables is available in Table I above.] The data was taken from Compustat and the Corporate Library databases and does not include financial firms and founder firms. The Arellano test (firm, year) was used for the calculation of White's heteroskedasticity-consistent covariance matrix. (t-statistic is reported in parentheses. The notations ***, **, * indicate significance at the 99%, 95%, and 90% levels respectively.)

Dependent Variable: Log(Tobin'sQ)		**2010 -2011**	
Variable	Beta (t-statistics)	Variable	Beta (t-statistics)
Intercept	1.0891 (2.3749)**	Year	-0.000076647 (-0.0075)
EffectiveStaggeredBoard	-0.074941 (-1.87)*	Year*Industry 1	-0.0016802 (-0.1255)
Industry 1	-0.004945 (-0.129)	Year*Industry 2	-0.024542 (-1.753)*

Industry 2	-0.034093 (-0.7365)	Year*Industry 3	0.0141 (0.7458)
Industry 3	-0.044256 (-1.1483)	Year*Industry 5	0.035732 (1.3936)
Industry 5	0.07306 (0.8371)	Year*Industry 6	-0.010937 (-0.316)
Industry 6 (tech)	-0.066755 (-1.2653)	Year*Industry 7	0.0002831 (0.0209)
Industry 7	0.00066527 (0.0181)	Year*Industry 8	-0.015513 (-1.4653)
Industry 8	-0.011387 (-0.215)	Year*Industry 9	0.021092 (1.3019)
Industry 9	-0.048697 (-1.247)	Year*Industry 10	-0.016908 (-0.3803)
Industry 10	0.039652 (0.4546)	FamilyFirm	-0.050407 (-2.2626)**
LOG(Size)	-0.58554 (-1.7162)*		
InsidersPlusPctgShares	0.08454 (1.9064) *		
%DirectorsOutside	-0.046767 (-0.8924)		
IneffectiveStaggeredBoard	-0.036011 (-1.2798)		
InstitutionalMajority	-0.01143 (-0.9701)		
Log(MarketValue)	0.028141 (0.1716)		
Log(MarketValue)^2	0.056641 (2.1833)**		
LOG(Size)^2	0.032435 (0.5995)		
Delaware Incorporation	-0.013504 (-0.6227)		
N	202		